

Below is a translation of an article that appeared in finance et investissement, mid-October, 2010

## Harold Scheer combines prudence with opportunism

### Baker Gilmore sees more good opportunities in the bond markets

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**Harold Scheer is president of an independent investment management firm attached to a major financial group. He believes he is living in the best of both worlds.**

“There are six investment professionals at **Baker Gilmore**, and we own 50% of the company,” affirms Harold Scheer. This is consistent with the philosophy of the Connor, Clark & Lunn Financial Group, a multi-boutique asset management firm based in Vancouver. Moreover, the affiliated managers own a stake in the company they work for.

The ownership level reinforces the commitment to Baker Gilmore. “I think it is important that our clients know that when they sign on with Baker Gilmore, the team will be the same in 15 years.”

However, Connor, Clark & Lunn Financial Group is much more than a financial partner; the Financial Group manages compliance, information systems, sales, accounting and marketing.

“This structure provides us with some attractive economies of scale,” he adds, noting that the Connor, Clark & Lunn Financial Group affiliated managers are responsible for more than \$35 billion in assets under management.

The Baker Gilmore team can therefore concentrate on portfolio management and client servicing,” says Scheer, who also holds the position of Chief Investment Officer. “I know I’m not a business manager. My expertise is portfolio management.”

#### ***Creating value***

This set-up is bearing fruit for the investment management firm headquartered on McGill College Ave., and it has always managed to create value for its clients.

Since its inception on December 31, 1993, the Baker Gilmore Bond Fund has yielded an annualized return of 7.53%, i.e. 0.54% more than the DEX Universe Bond Index. This rate has actually increased over the last five years, with a value added of 0.73%.

This fund was especially effective during difficult market periods. In fact, it has posted added value in comparison to the DEX Universe Bond Index in 68% of bear market months and 52% of bull market months.

Cumulatively, the fund has added 6.9% in value during bear markets and 1.8% in bull markets.

### ***Early history***

Harold Scheer has been a fixed-income specialist since the beginning of his career. With an MA in international economics from Geneva's Institut de Hautes Études Internationales et du développement, the Montreal native began his career with **Crown Life Investment Management**.

In 1998, Crown Life was sold to **Canada Life**. "We had the opportunity to take the investment arm and shape our own business," recalls Scheer. He founded the firm **Scheer, Rowlett & Associates**, which later joined with Connor, Clark & Lunn Financial Group.

Connor, Clark & Lunn Financial Group then bought Baker Gilmore in 2000, and a year later, Scheer and his colleague François Melançon, as well as the fixed-income assets of Scheer, Rowlett & Associates came under the management of Baker Gilmore.

For six years, Scheer has chaired the organizing committee of Montreal's Austrian Ball, a gala evening that celebrates the tradition of the Viennese ball. "We are raising funds for General Roméo Dallaire's Foundation," he says. This year's ball is being held November 27th at the **Marriott Château Champlain**.

### ***The economy first***

Baker Gilmore manages about \$4 billion in fixed-income assets under management. Pension funds are its main clients, accounting for 40% of assets. Insurance companies represent approximately 25% of the total, and foundations come in third at 11%.

In the retail market, Baker Gilmore manages 10% of its assets in wrap accounts, such as **AGF's** Harmony and **Desjardins'** Darwin programs, and 7% in private management through **Connor, Clark & Lunn Private Capital**.

Economic forecasts are the basis of a bond manager's strategy, explains Scheer. "When we build our portfolios, we start with our predictions on interest rates and credit spreads [between government and corporate bonds]."

As far as interest rates are concerned, Baker Gilmore makes forecasts over a period of 12 to 18 months. "In the short term, there are just too many unpredictable factors affecting interest rates and spreads."

The firm's specialists study market trends to determine if they are going to extremes, for technical or emotional reasons. "We've seen these situations where markets have hit emotional extremes. In 2007, for example, markets were being too optimistic. When that happens, you need to reduce portfolio risk."

Later, when the market became too risk averse, action was taken. "A 500-basis-point spread for asset-backed securities did not make sense," he says.

Baker Gilmore's risk management arm enabled the firm to get through the financial crisis without any credit default, adds Scheer. "We held Bank of America and Citicorp. But towards the end of 2007, we saw risk for these banks, because the risks were greater for the U.S. economy than for Canada's. We sold everything before the end of 2007."

### ***Risk management***

Sound risk management does not mean we should be conservative. In the wake of the **Lehman Brothers** bankruptcy, the spreads between government and corporate bonds increased. Baker Gilmore took the opportunity to invest in corporate bonds. "In the fourth quarter of 2008, we added more high-quality corporate bonds, where the spreads seemed illogical."

"But you had to be certain that the credits were very strong," he adds. "We did not buy the industrial sector or ABCP because there was no transparency in these products." The firm had acquired bank corporate bonds and asset-backed securities (such as commercial mortgages).

This strategy has increased returns. "From March 2009 to March 2010, we outperformed the benchmark by 730 basis points, which is extraordinary for bonds."

### **2011 and beyond. . .**

Earlier this year, Baker Gilmore projected an increase in the Bank of Canada's overnight rate. The economy was strong, especially the real estate market.

However, even before the Bank of Canada decreed its first interest rate increase in June, something happened that re-shuffled the cards. "The crisis in Greece has greatly changed the global situation because it woke governments up to the fact that they had to watch their deficits," explains Scheer.

Many governments have begun to raise taxes or cut spending. These measures slow the economy, he adds. "This ensures that the central banks will let interest rates wallow for an extended period. The **Fed** will remain at these levels until 2012, maybe 2013."

Indeed, the unemployment rate is so high in the U.S. that it will take its American economy several years to reach some sort of equilibrium. In the construction sector, for example, the unemployment rate is 16 to 17 percent.

### **Not so bad**

The future is not altogether gloomy, though. Scheer does not believe that the slump will last as long as in Japan. "Most of the unemployed are young, so it's easier for them to retrain themselves."

In addition, companies are still posting a lot of profits, and productivity is good, but debt reduction will take some time, the specialist believes. "I don't think we'll have a second recession, but growth will be slow and some volatility will remain."

This volatility should provide good opportunities. "The environment for the next three to five years is positive for active managers who focus on risk management." The "positive" outlook here is in spite of an environment where interest rates are low. Canadian 30-year bond yields are at less than 3.5%, which is very low.

"Rates are low, but we do not believe they will rise substantially over the next 12 months."

There is a demand for Canadian bonds, however, especially among pension funds and foreign investors, who are buying them as never before, even though they are only yielding 3.5%.

"The market is seeking instruments of capital preservation. In addition, the risk premium is still high in the markets, so we don't need to take excess risk in our portfolios in a bid to get returns that are higher than the benchmark index."

After increasing rates by 100 basis points, the Bank of Canada should pause, concludes Scheer. "I would say the BoC will eventually raise the overnight rate again, but then it should perhaps wait until the end of 2011."

### **Extra**

Read about the DEX Universe Bond index in *finance-investissement.com*.

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